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Initial Public Offerings (IPO's) Underpricing: A Study of Selected Stocks in the Indian Primary Market

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ABSTRACT: *The study has made an attempt to analyze the Indian primary market in order to observe the phenomenon of underpricing in the Indian context. And the duration considered is from 2011 to 2014, which includes the companies that has gone public and is been listed in NSE as well as BSE. An observation made in the study is that the phenomenon of underpricing has been existed in these years i.e. for the years 2011 to 2014 in the Indian context. As Ritter have also suggested about the risk which is undertaken by the uninformed investors for making a venture in the IPO. Over 108 companies are taken into consideration for the study for the year 2011 to 2014. So finally study declares the presence of underpricing in the Indian context as it is experienced in other stock market worldwide.*

KEY WORDS: *Initial Public Offering, Securities Exchange Commission (SEC), Stock Exchange, Book Building.*

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I. INTRODUCTION:

Usually IPO which is well known as the process through which a company privately held, issues the shares of stock in its history to the general public for the first time. In general, it is also termed as "going public," so by the process of IPO a small business is transformed from a privately owned company into an operated entity into the one which the shares of the company is been owned by a public stockholders. An IPO is a significant stage in the growth of many small businesses, as it provides them with access to the public capital market and also increases their exposure and credibility. Including a loss of flexibility and control for management, becoming a public entity involves significant changes for a small business. In many cases, however, an IPO may be the only means left of financing growth and expansion. Sometimes the decision to go public is influenced by founders or the venture capitalists who wish to cash in on their investment quite early.

IPO is a very expensive and also a staging and is time consuming process. In order to sell the stock to the general public, a small business must apply to the Securities and Exchange Commission (SEC) for permission, if it is interested for going public or issue shares to the general public. The registration process of SEC is quite complex in nature and also requires by the company to disclose a variety of information to the investor who are quite potential. So the process of IPO can take as long as two years or as little as six months , during which the attention of time management is been distracted from the operation of day-to-day basis. Usually a cost between $50,000 and $250,000 is the underwriting fees for a company going for public in general, and other related costs are legal expenses and accounting expenses, and printing costs etc.

Overall, going public requires planning and careful consideration and is a complex decision. As recommend by the experts is that, all the alternatives is been first considered by the small business owners (such as Direct public offering, forming a limited partnership or joint venture, self-underwriting or selling shares through private placement, or a securing venture capital), examine their future capital and current needs, and also be aware of how an future financing availability is been affected by the IPO process.

II. REVIEW OF LITERATURE:

David R. Williams, W. Jack Duncan and Peter M. Ginter (2010) have analyzed the relationship among secondary-market, Pre-market, and the primary-market characteristics. Signalling theories and the agency theories have been utilized in the study. Study examines the high-technology firms which are seeking for an IPO for the agency and market signals which is related to a sample chosen for the study. For the purpose of examining for IPO offer process in high-technology firms a model have been tested. The results of the study indicates the secondary market factors have not affected the offer price of the IPO but the offer price is affected by certain primary market and Pre-market factors which is received by the entrepreneurs and the investors.

Brett D. Cotton (2008) the long-run underperformance of IPO firms was first observed by Ritter (1991) first. This underperformance of IPO is termed as new issues puzzle. One possible explanation which can be given to puzzle of new issue is that prior to IPO's the managers concerned may manipulate earnings upwards, by inducing the mispricing and during the years following the IPO issue it is reversed (Teoh, Welch, and Wong, 1998). Study has made a comparison between the discretionary accruals of performance matched and the abnormal stock performance of the firms which is issuing only the primary shares with those companies issuing only the secondary shares or it can be a combination of both primary shares and secondary shares in order to examine the above explanation. So finally the evidence supporting the hypothesis, which is the earnings management, contributes to the long-run under performance of IPO's as indicated in the study.

Krupa S. Viswanathan (2006) has examined the pricing of the IPO's which follow the insurance company demutualization. The insurers typically mention the need for capital requirement as a key motivation who convert from mutual to stock form. The primary regulatory objective of insurers is the capital adequacy for which one would expect that a given number of shares to be sold; Hence in order to maximize the offerings proceeds these firms would price their offerings in such a way. However, as observed in the vast literatures on pricing of IPO various theories suggests that to underprice firm's offering is to why it may be in the issuing firm's best interest. So by examining the long run returns and the initial returns of stock the degree of underpricing and the existence of underpricing which is characterized by initial returns which is quite high can be determined. As the observation made by the study that on an average the demutualization insurer IPO's posts considerably higher initial day returns compared to non-demutualization insurer IPO's. Finally during the period of first few years after the IPO attractive returns are sustained for both the groups of insurers.

Anlin Chen and Lanfeng Kao (2006) investigate to mitigate the winner's curse; a simple way in the process IPO is to lessen the number of investors who are informed in IPO markets. As the study signify that the institutional investors in Taiwan are not permitted to subscribe to IPO's of fixed price. So excluding the institutional investors it raises the uninformed investor's allocation rates. The winner's curse is still present in the Taiwan's fixed price IPO markets as the results which are obtained from the study, even without the institutional investor participation. Underpricing of IPO is reduced by at least 4 percent because of alleviating the winner's curse, as institutional investors are excluded from the fixed price offerings as shown by the study.

Objectives of the Study

- To examine the different IPO issues for different years in NSE and BSE
- To empirically test the underpricing or overpricing IPOs of Nifty and Sensex

III. DATA COLLECTION AND RESEARCH METHODOLOGY

- An attempt is made to collect the data from the secondary sources of data, which is collected from the secondary sources such as publications, journals, Capital Line Database and also from different websites like BSE and NSE.
- The research design for the current study is more of exploratory and descriptive in nature for which the quantitative approach is been used for the analysis of the chosen data.

Analysis and Interpretation

Both the tables are represented for the data set undertaken between the years 2011 to 2014.

Table: 1 shows the value of skewness

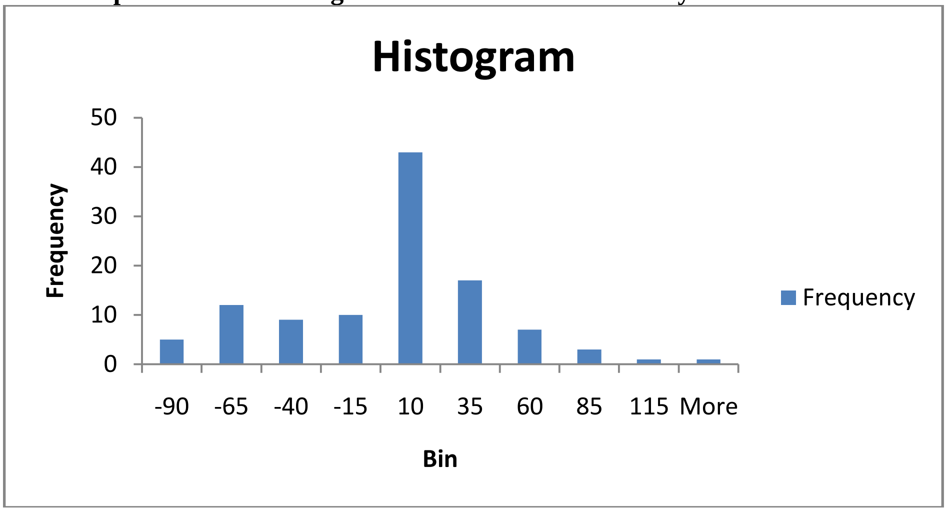
Column1	
Mean	-10.20802888
Standard Error	4.293686763
Median	-0.354166667
Mode	0
Standard Deviation	44.62130175
Sample Variance	1991.06057
Kurtosis	0.968588326
Skewness	0.134964845
Range	250.6454545
Minimum	-97.14545455
Maximum	153.5
Sum	-1102.467119

Table: 2 Shows the frequency of companies

Bin	Frequency
-90	5
-65	12
-40	9
-15	10
10	43
35	17
60	7
85	3
115	1
More	1

Table 1: shows the positive value of skewness representing the presence of underpricing for the investors for which the investors gain positive returns by underpricing.

Graph - 1: shows histogram for the IPO issues of the year 2011 to 2014



Interpretation:

- The value of skewness obtained from the data for the different years, which is from 2011 to 2014 histogram is 0.13.
- The value obtained is positive which represents the presence of a moderate degree of positive skewness.
- The value of mode obtained is also positive and is equal to 0.
- Hence it can be said that there exists a phenomenon known as underpricing as the returns obtained by the investors are positive.

IV. CONCLUSION:

So finally by analysing the data for various years of public offerings in the study, it can be concluded that in the Indian equity markets underpricing of IPO's exists. It has been observed in the study by considering a data set of 108 IPO's for the periods 2006 to 2011. As it has been observed from the extant literatures that the phenomenon of underpricing is present worldwide and in case of Indian scenario it is not an exception. The study accepts the argument of the Ritter who states that underpricing is required in order to compensate the risk taken by the uninformed investors. As they don't posses any information relating to the company prior to the issue of IPO's.

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